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1 NOV 1983

MEMORANDUM FOR: (See Addressee List)

FROM:

[Redacted]

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Director of Global Issues

SUBJECT:

The "Gray Market" in Nuclear Materials:
A Growing Proliferation Danger [Redacted]

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1. The attached memorandum examines the growth and importance of the international clandestine market in nuclear materials. A number of Third World proliferators have used West European brokers to acquire sensitive nuclear-related technologies. At the same time, these brokers have become increasingly sophisticated in exploiting ambiguous domestic export control laws and nonproliferation guidelines. We plan to devote further resources to study this growing proliferation threat and will report our findings periodically. [Redacted]

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2. This memorandum was prepared by [Redacted] International Security Issues Division, Office of Global Issues. [Redacted]

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3. Comments and queries regarding this subject are welcome and may be addressed to the Chief, Weapons Proliferation Branch, OGI, on [Redacted]

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Attachment:

The "Gray Market" in Nuclear Materials: A Growing Proliferation Danger GI M 83-10255, October 1983 [Redacted]

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GI M 83-10255

[Redacted]

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Central Intelligence Agency



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

28 October 1983

The "Gray Market" in Nuclear Materials:
A Growing Proliferation Danger [redacted]

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Summary

Several developments in the last decade have facilitated the growth of an international clandestine market in nuclear materials. Competition for sales, which increased with the emergence of new suppliers of these materials, has helped to erode the Western exporters' consensus on the regulation of trade in nuclear materials. At the same time, some proliferators--generally working with one of the small number of international brokers--have become increasingly sophisticated in their efforts to circumvent established nonproliferation guidelines. These "gray market" activities strain the global nonproliferation regime which is not now comprehensive enough to regulate such activity. [redacted]

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This memorandum was prepared by [redacted] International Security Issues Division, Office of Global Issues. This analysis is based on information as of 27 October 1983. Comments and queries are welcome and may be addressed to Chief, Weapons Proliferation Branch, OGI [redacted]

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GI M 83-10237
October 1983

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Emergence of the Gray Market

Gaps in the coverage and effectiveness of the global nonproliferation regime have facilitated the development of a gray market in nuclear materials.¹ The regime prohibits government sales of certain sensitive nuclear materials and technologies to non-nuclear weapons states in order to discourage the use of nuclear technology for nonpeaceful purposes. It operated reasonably well as long as the suppliers of nuclear materials were few and they shared a common view on the types of materials and assistance requiring regulation. In the last decade however, several developments have contributed to the spread of nuclear technology to many countries, which made it easier for a clandestine nuclear market to develop and operate. These changes include the:

- emergence of new suppliers of nuclear materials;
- erosion of the Western suppliers' consensus on a "philosophy" of regulation in the face of economic competition; and
- growing sophistication of Third World proliferators in circumventing established nonproliferation guidelines.

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The gray nuclear market thrives in this environment. Venturesome entrepreneurs have made large sums of money in recent years by brokering clandestine nuclear sales. [redacted]

[redacted] they operate by exploiting ambiguous domestic export control laws and less than comprehensive international regulations. [redacted]

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Motivations

Governments or firms in countries that pose a proliferation threat generally use the gray market to acquire nuclear materials or assistance because it offers opportunities to conceal or partially conceal nuclear transactions [redacted]

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[redacted] Specifically, buyers turn to the gray market because it may provide:

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- the only source of a nuclear material that is legally embargoed to a potential proliferator;

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¹The gray market in nuclear materials involves the sub-rosa transfer of nuclear equipment, materials or technologies. Many gray market activities are technically legal under national export laws but violate the spirit of a country's nonproliferation policies and/or international agreements. [redacted]

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-- an unregulated source of a nuclear material for a country that wants to acquire unsafeguarded materials for its indigenous program; or

-- a convenient way for a country to disguise its nuclear intentions and avoid the political and diplomatic problems of dealing on a formal government-to-government level.

[redacted] 25X1

From the seller's perspective, clandestine nuclear-related sales have helped maintain the financial solvency of many West European nuclear firms. Nuclear firms in West Germany, Italy, Switzerland, and Belgium increasingly use middlemen to mask sales of potentially sensitive nuclear products to developing countries' nuclear programs [redacted] 25X1

Anatomy of a Gray Market Transaction

A typical gray market nuclear transaction generally follows a set pattern, [redacted] First, the government of a proliferating country either directly or through a cover firm solicits price quotations for the nuclear material sought. Governments vary in how they carry out this first step, [redacted] 25X1

[redacted] Pakistan, for example, frequently deals through dummy firms set up by their procurement officers who operate under diplomatic cover out of Pakistani embassies in Western Europe. India, however, usually does not go to such elaborate ends to launder its nuclear purchases, usually listing legitimate private firms rather than government facilities as the purchaser. Argentina's Atomic Energy Commission, on the other hand, negotiates directly with Western European firms and brokers. [redacted] 25X1

In the second step, a procurement official may go directly to a West European nuclear firm or may commission a broker to arrange the nuclear-related purchase. [redacted] 25X1

[redacted] the more sensitive the acquisition, the more likely a broker will be used to disguise the sale. A line of credit at a bank subsequently is opened in the broker's name, and delivery of the goods is arranged. [redacted] the three most common methods of making gray market deliveries are: 25X1

-- Export of nuclear equipment as component parts where the components alone appear innocuous and may not require an end-use declaration under national export laws.

- . -- Falsification of end-use statements if delivery is made directly to a country of obvious proliferation concern, such as Pakistan.
- Transshipment of the nuclear-related goods to a third country with lax national export control laws. The United Arab Emirates and Turkey often are used as third-country transshipment points because of their loose export control scrutiny.

[redacted] the general pattern of a well-known Dutch broker, for example, is to set up a line of credit in the Netherlands, funded by Pakistan's Engineering Research Laboratory, to buy nuclear material from West German or Swiss firms. This material is then exported to another West European or Middle Eastern country for ultimate delivery to Pakistan. [redacted]

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Prospects

We believe sub-rosa procurement networks in nuclear materials will likely grow, as the financially lucrative business of brokering nuclear materials trade attracts more entrepreneurs. As long as domestic commercial pressures to permit a wide gamut of nuclear exports remain high, West European suppliers are unlikely to view the proliferation impact of gray market activities as a serious political problem.² Furthermore, the difficulties all Western governments face in regulating the transnational dealings of private firms within their borders also are unlikely to lessen. Even when illegal activities become known to a government, it is hard to prosecute because of the transnational nature of the broker's activities. The lack of effective international regulation of their activities facilitates the business of gray market operations. Confidence in the nonproliferation regime may be seriously strained as gray market activities continue because the regime has few, if any, regulatory mechanisms to stop such activities. [REDACTED]

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Nuclear Materials: A Growing Proliferation Danger

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SUBJECT: The "Gray Market: in Nuclear
Materials: A Growing Proliferation Danger [REDACTED]

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OGI/ISID/WP/[REDACTED] (27 October 83)

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